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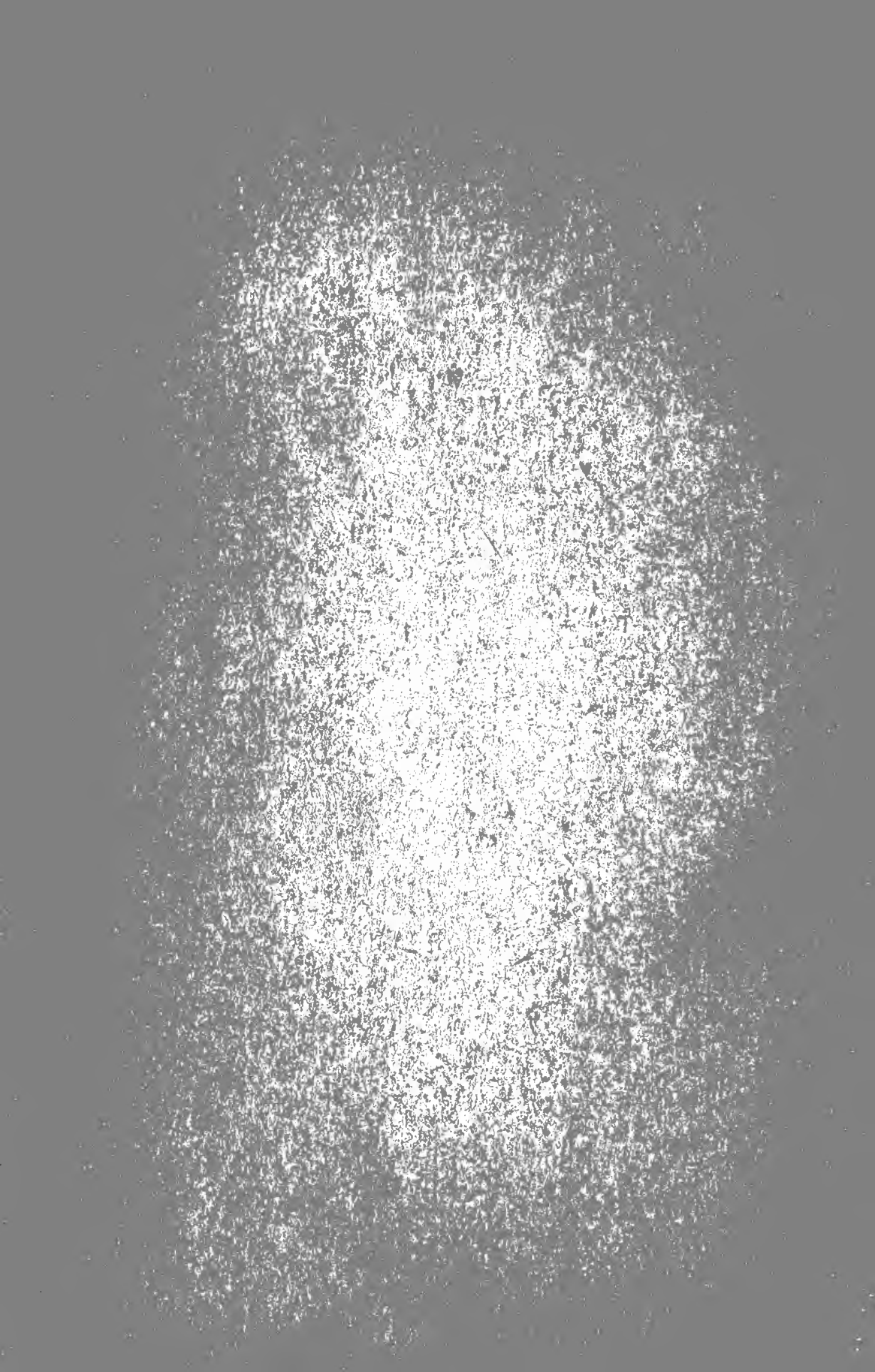


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**ECONOMIC NOTES**  
**ON**  
**INSULAR FREE TRADE**

**BY**  
**THE RIGHT HON.**  
**ARTHUR JAMES BALFOUR, M.P.**



*SIXTH IMPRESSION*

**LONGMANS, GREEN, AND CO.**

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## PREFACE

THESE Economic Notes were circulated to my colleagues in the first days of August substantially as they are now reprinted. A few alterations have been made, chiefly for the sake of clearness; and two brief illustrative tables have been added in an Appendix (p. 32). Though the argument is occasionally somewhat abstract, and occasionally somewhat compressed, I think that perhaps a larger circle than that for which the paper was originally written may like to have an opportunity of reading it. Hence its publication.

It is one of the difficulties inherent in the present controversy that some important points can hardly be made interesting, or even intelligible, on the platform without an amount of expansion and illustration which would render it impossible to put them in their proper setting within the limits of a single speech. The more general, and in some respects more theoretical, treatment of the problem attempted in this essay may, therefore, be a fitting preliminary to the statement which it will be the duty of the writer in a few days to make before a public audience.

A. J. B.

DOWNING STREET, *September* 1903.



## ECONOMIC NOTES ON INSULAR FREE TRADE

IN the following Paper I propose to discuss some of the more fundamental economic questions which (as I think) require consideration on the part of those who desire to arrive at a sober and unprejudiced estimate of our fiscal policy. The present controversy has brought into existence, or at least into notice, masses of statistical information, official and unofficial; the documentary flood is rising, and for some time to come is not likely to diminish. But in order that the volume of facts thus provided should instruct and not merely overwhelm us, it is necessary to consider it in the light of theories and principles, always, of course, open to revision in the light of experience, but without the provisional use of which experience itself can utter no intelligible oracles.

It may be as well to premise that I approach the subject from the free trade point of view: though the free trade is perhaps not always that which passes for orthodox in the House of Commons or on the platform. There is indeed a real danger of the controversy degenerating into an unprofitable battle of watch-words, behind which there is nothing deserving to be called independent reflection at all. Popular disputation insists on labels; and likes its labels old. It therefore divides the world, for purposes of fiscal controversy, into protectionists and free traders. Those who are protectionists are assumed to be protectionists after the manner of Lord George Bentinck. Those who are free traders are assumed to be free traders after the manner of Mr. Cobden. Does a man question the dogma that taxation must always be for revenue? Then evidently he

hankers after the fiscal system of 1841 and a twenty-shilling duty on corn. Does he admire the tariff reforms of sixty years ago? Then evidently he regards the simple and unqualified doctrine of "free trade" as so fundamental in its character, so universal in its application, so capable of exact expression, that every conclusion to which it logically leads must be accepted without hesitation or reserve.

I am a "free trader," but not, it must be acknowledged, precisely after this pattern.

## I.

1. That there may indeed be a collision between free trade and greater issues is easily seen if we reflect that an ideal world, from a narrowly economic point of view, would be one in which capital and labour would flow without hindrance to the places where profits were greatest and wages highest. Under the stress of economic forces they would immediately adjust themselves to a position of temporary equilibrium, as the ocean adjusts its level under the force of gravity. Such a system, were it possible, would certainly be one of "free trade" in the fullest sense of that much abused term, and under it the wealth-producing capacities of mankind would be all that free trade can make them. —

2. But this perfect fluidity of capital and labour, however excellent its other consequences, would evidently be inconsistent with national life as we understand it. Nations could not be maintained, at least in their present shape, except through the accumulated effect of the various causes which in their sum total make up what may be called "economic friction," just as the continents on which they live are only prevented by cohesion and mechanical friction from merging in the ocean by which they are surrounded. It is because mankind are largely ruled by custom, are fond of home and country, cannot easily acquire new aptitudes and new languages, cannot migrate without cost and risk, that labour is not "fluid." And though certain kinds of capital are really

fluid, yet as a whole capital also is "viscous"; and partly because much of it is in a shape which cannot easily be moved or cannot be moved at all; partly because business channels are changed slowly and with difficulty; partly because, when the owner of the capital has to superintend its employment, he may, like other workers, be reluctant to change his home and his country, *it* also flows but gradually to the places where, under a system of "free trade" as above described, it would find its most profitable employment.

3. Nations, as we know them, are therefore economically possible only because, for various reasons, mankind are both unable and unwilling to turn the natural resources of the world to the best economic account. It is the partial immobility of capital and labour to which this result is due, which makes it necessary for economists to distinguish between the theory of international, and the theory of internal trade. And though the "countries" which figure in economic treatises as the units between which international trade takes place, are not necessarily identical with the "countries" which are the subject of international law, the fact remains that these last,—the actual nations into which the world is parcelled out,—would never have come into being, and could never be maintained as they are, but at the cost of something which, from the point of view of pure free trade theory, must be regarded as economic waste. And inasmuch as they are thus a standing violation of cosmopolitan free trade (as above defined) it is not surprising that in their efforts at self-preservation they have not felt themselves bound to consider only arguments drawn from cosmopolitan economics. They have taken into account, not always wisely, something more than the present pecuniary interest of individual consumers and producers, they have recognised that the state is something more than the individuals composing it at any one time, and that not only is it irrational to suppose that what is good for the wealth-producing capacity of the world must necessarily be good for each particular state; but that quite certainly it is not.

4. This last proposition would have been accepted by

Adam Smith; and so far as I know would be denied by no economist of repute. But there is nevertheless a widespread idea that what is economically "natural" as opposed to what is artificial or state contrived, is probably expedient, and that at least the burden of proof lies with those who take a different view. This theory, which belongs to a somewhat antiquated mode of thought, is I think incorrect. Each suggested example of state interference, in this or any other sphere of activity, has of course to make good its claim to acceptance. But it would be a most singular coincidence if (for example) every "natural" cause which promoted the easy flow of capital and labour from area to area, should also promote the interests of particular nations, the number of whose population and the character of whose commerce are largely founded upon the partial immobility of these very partners in production.

5. There is no doubt a better argument against state intervention in matters of trade than any to be extracted from the *a priori* social theories so fashionable in the eighteenth century—an argument based on a deep-seated distrust of the competence of Legislatures. Adam Smith, for example, held much the same opinion of Kings and Parliaments as some persons do of doctors. He did not doubt that tonics might be found to invigorate national commerce, but he did most gravely doubt whether the authorised practitioners would find them. This however is hardly an assumption on which we can proceed in these days of Factory legislation, Housing legislation, compulsory Education, inspection of Mines, and Mercantile Marine Acts. Parliament can hardly assume its own incompetence as a fundamental axiom, however plausible this may appear as a working hypothesis. Having recognised the general truth that there is no pre-established harmony between economic world interests and national well-being, we seem required to abandon the "*laissez faire*" position as absolute dogma, and to accept provisionally the view that the character of our fiscal policy should vary with varying circumstances, and that we have no right whatever to

regard any plan as perfect, merely because it is simple, unartificial, and, above all, familiar.

## II.

6. The plan we should adopt must evidently depend upon the end we wish to secure, upon the kind of state we desire to create or to maintain. Without considering the motives which have from time to time dominated the fiscal policy of other countries, it is only necessary here to say that so far as Great Britain is concerned, the contest which came to an end in 1846 was, in its inner reality, not a fight over an economic theory, but a struggle between two opposing ideals supported by two rival interests. Was the country to become more and more a manufacturing community? or was agriculture to be maintained, at whatever cost, in its ancient predominance, with all the social and economic consequences which were, or were thought to be, involved in such an attempt?

7. The country decided (in my opinion rightly) in favour of the first of these alternatives. Its benefits, to be sure, have not been unmixed; but it has this conclusive argument in its favour,—that a predominantly agricultural Britain could never have supported the men or furnished the money required for her imperial mission.

It must, however, be remembered that this “manufacturing ideal” can only be made tolerable, indeed can only be realised, if two conditions are satisfied:—(a) that inasmuch as conditions of climate render it obligatory to import many of our luxuries, and conditions of population and manufacture render it obligatory to import many of our necessities, a large export trade is necessary in order that these things shall be paid for; (b) that sufficient capital shall always be forthcoming for *home investment* in order that this end may be attained, and employment provided for our growing urban population.

8. These corollaries which flow from the adoption of the manufacturing ideal in a country situated like Great Britain, suggested no anxious thought to fiscal reformers fifty or

sixty years ago. They made, indeed, two mistakes, neither of which (as I shall show more in detail presently) would, perhaps, have greatly mattered without the other. They failed to foresee that the world would reject free trade, and they failed to take full account of the commercial possibilities of the British Empire. If they had been right on the first point, if free trade had indeed become a universal creed, no controversy about our commercial relations with any fiscally independent community could possibly have arisen. If, on the other hand, they had succeeded in giving us Imperial free trade, the protective tendencies of foreign nations would in the long run have been but of secondary importance. The double error has established insular free trade with its inevitable limitations, and left us bearing all the burden, but enjoying only half the advantages, which should attach to Empire.

9. It must, I think, be accounted a misfortune that the views of the great tariff reformers were thus restricted. The most momentous, perhaps the most permanent, victory for Free Trade was won when, rather on national than on economic grounds, inter-state tariffs were forbidden in the United States. I know not whether sixty years since a like victory might have been won for the same cause within the limits of the British Empire. In any case, the attempt was neither made nor dreamed of, and future efforts in that direction can, under altered conditions, be only gradual and tentative.

10. However this may be, we must now accept the fact that while our own free trade is rather insular than imperial, the most advanced of our commercial rivals are not only protectionist now, but in varying measure are going to remain so. Other nations have in the past accepted the principle of free trade ; none have consistently adhered to it. Irrespective of race, of polity, and of material circumstances, every other fiscally independent community whose civilisation is of the western type has deliberately embraced, in theory if not in practice, the protectionist system. Young countries and old countries, rich countries and poor countries, large countries and small countries,

free countries and absolutist countries, all have been moved by the same arguments to adopt the same economic ideal. In circumstances so little foreseen we are driven to ask *whether a fiscal system suited to a free trade nation in a world of free traders, remains suited in every detail to a free trade nation in a world of protectionists.*

### III.

11. As already stated, I approach this question as a free trader, *i.e.*, with the desire to promote free trade as far as contemporary circumstances permit. I throw no doubt on the free trade theory when expressed with due limitations. It tells us that international free trade promotes wealth, because it conduces to an international division of labour. Each country is enabled to turn its industrial capabilities to the best account; to purchase what it wants but cannot produce, or wants but cannot produce except at a relative disadvantage, by the export of those commodities for the production of which it is in a position of relative advantage. This system, therefore, tends to secure that each country does most what it does best, and buys what it needs at the least possible cost.

12. There can, I think, be no question that, speaking broadly, this is the best way of securing for the world the largest immediate results for international commerce and industry. It is by no means equally certain that it secures for each separate nation the maximum of well-being; nor even (under conceivable conditions respecting the flow of capital and labour) the maximum of wealth. Moreover, the majority of economists hold (I think rightly) that it may sometimes sacrifice the future to the present, and delay what might ultimately have proved to be the most productive distribution of capital and labour.

13. It is not, however, with these qualifications of the doctrine of universal free trade that we are now principally concerned. Our business is with the only free trade which we are ever likely to see; namely, free trade in some nations limited by protection in others. Of this partial free trade we

may say in general, that its merits must be accepted with all the reserves already mentioned, and with this one in addition—that under conceivable circumstances free trade may not save a nation from suffering more by the adoption of a protective policy by its neighbours than do those neighbours themselves, nor even from being worse off than it would have been had it never pursued a free trade policy at all.

#### IV.

14. In what way then can this take place,—what is the precise nature of the injury done to a free trade country by the adoption of protection by its neighbours? Presumably such a country bears its share in the general economic loss which the widespread adoption of a bad fiscal system inflicts on the world at large. Does it in addition suffer any special loss?

This is in other words to ask what is the special value to a free trade country of open markets. That our whole national policy implies their value is plain enough. We negotiate strenuously to maintain those that exist; there are some for which we should assuredly fight. It would be commonly admitted that the absorption by a protective nation of any rich non-protective area with which we had commercial dealings would produce not merely a temporary disturbance of our trade, but a sensible diminution of our permanent gains.

15. If this be true, it is of course because any check to our export trade is injurious. But why is it injurious? From the consumer's point of view, at least, it would seem that it is only what we import that matters. And in a sense that is so. But since the fortunes of the import trade are indissolubly united with those of the export, it may well happen that though the exporting manufacturer is the first to feel the pinch of hostile tariffs, it is the importing consumer who ultimately suffers.

16. Consider, for example, a simple case. Suppose that an island, which had shaped its industrial system on the Cobdenite

model, found itself confronted by a world in which every other state adopted an extreme form of protection. What would be the consequence of such a situation to the island itself, and in a less degree to other countries? The answer to this question must, I conceive, vary according to the economic characteristics which we choose to attribute to our imaginary example.

17. Take for consideration three variations of the problem. Let us assume, in the first place, that the productive capacity of our imaginary island is small in amount, and restricted in range; and further, that it can neither grow nor manufacture anything which cannot, with the help of protection, be grown or manufactured at a profit in the protective countries. In such circumstances I conceive that the fiscal policy of these countries would completely ruin it; and that they would suffer but little in the process. This case I may parenthetically observe is not unlike that of our own colony of St. Vincent where, according to the Commission of 1900, nothing could be produced but sugar,—sugar, which under the then prevailing system of bounties, could nowhere be sold except at a loss.

18. An economic area so situated is helpless. Having founded its industrial system on a free trade basis, having encouraged the growth of population and the investment of capital, in the belief that it could readily purchase what it needed by the sale of its exports, it discovers that, by no fault of its own, nor through any operation of nature, this sale is becoming more and more difficult; that only by the reduction of profits and wages can it be temporarily continued; and that finally it becomes impossible. Capital either flies to happier regions or is lost; labour either emigrates or sinks to savagery, and unless other help arrives our island returns to the state of nature from which it had surely been better that it had never emerged.

19. This represents of course an extreme case of economic dependence. Let us now consider one of the opposite type. Assume that our imaginary island is of vast extent, enjoying consequently great varieties of climates, with a population small

compared to its food-producing area, and with natural resources fitted to minister to all their needs. Such a country finding its exports gradually diminished by growing foreign tariffs, would, no doubt, suffer some economic loss. But it will be very differently situated from St. Vincent. Though it will have to manufacture at home much that it hitherto imported, though capital and labour would be diverted into channels which, at least for a time, would be less advantageous than those through which they had hitherto flowed, yet in the long run the condition of such a country would, I conceive, not be seriously worse than if it had been permitted by its neighbours to pursue its industrial development along free trade lines. Though the markets of the world might be closed to it by protection, its own would not be seriously insufficient. Domestic free trade would be enough.

## V.

20. But now take a third case. Let us assume our imaginary island to be rich in mineral resources, and adequately provided with capital and labour, but to possess no striking advantages over other areas, no natural monopoly in respect of the things it was best fitted to produce. Let us further suppose that owing to the law known to economists as that of "diminishing returns," it could not find food within its own limits for a growing population, except at rapidly increasing cost, and that therefore free trade and industrial expansion involved increasing dependence on external areas of food supply.

21. Now, what would happen to a country thus naturally endowed, and thus industrially organised, if it found itself confronted with a universal system of augmenting tariffs? As an economic example it stands between our first case and our second. Which does it most resemble?

It cannot be doubted, I think, that though it could never find itself in the position of St. Vincent, it would not only be incomparably worse off than the larger area of our second supposition, but worse off than it would have been had it

never adopted the free trade policy, the advantage of which it has lost through the protective policy of its neighbour.

From the very nature of the case free trade requires open markets *somewhere*. If the free trade country is large enough and varied enough, the open markets within its own territory may, as we have just seen, be sufficient. They will not be sufficient if the character and capabilities of the country are limited in such a way that, while large imports are a vital necessity, the exports required to pay for them are not of a kind which other nations—all, by hypothesis, protectionist—are obliged to take.

22. I imagine that in the conditions supposed, the free trade island would be compelled to change the character of its industries so as to find the weakest spot in the protective barrier. Each change would probably involve a double loss,—the loss of part of the capital and skill devoted to the abandoned industry, and the loss due to the fact that the new industry was presumably less remunerative than the old. Each change would also, by supposition, be sooner or later foiled by some corresponding augmentation of the hostile tariffs. When all was got out of this industrial re-arrangement which it was capable of giving, the free trade island would have no resource but to purchase its imports by lowering prices to the point at which it became possible to force its manufactures through the tariff obstacles by which its exports were impeded. If no diminution of profits or wages enabled such a point to be reached, the island would no longer be able to support its existing population; nor would any equilibrium be attained until, at the cost of much suffering, it was reduced to the position of being self-sufficient—producing that is to say, within its own area, all that it consumed—however little soil, climate, and mineral resources lent themselves to such a policy.

23. It may perhaps be objected that this imaginary case is not instructive even as a hypothesis, since the protective countries would never be so foolish as to injure their own export trade by impoverishing, and perhaps ruining, a good customer. They might do it in cases like St. Vincent where

the amounts involved were small. But plain considerations of self-interest would seemingly forbid so suicidal a policy where the amounts involved were large.

But *are* the considerations of self-interest so plain? However sound be the economic doctrine on which they depend it is not one which easily appeals to protectionists. They would not be protectionists if it did. What they look to are the immediate and obvious consequences which are assumed to flow from high tariffs; and in the supposed case the obvious consequences are exactly what they desire. They would be so eminently satisfied with the successful "protection of Home Markets" and the weakening of a commercial competitor, that the more obscure causation of the counter-stroke which protection delivered against their own exporters would leave them unmoved. Here, indeed, if anywhere, the appeal to history should surely be conclusive. We have countless records of fiscal arrangements by which one nation has sought to benefit its commerce at the cost of another. Can a single example of the reverse process be produced? Has there ever been a nation which modified the commercial policy to which it was otherwise inclined, lest it should cripple the trade of a dangerous rival, who happened also to be an important customer? I trow not.\*

## VI.

24. Among the three variations of our original supposition we are clearly most concerned with the last. The industrial characteristics with which in that case we credited our imaginary community, are precisely those actually possessed by Great Britain. Why then, it may be asked, does Great Britain not suffer all the ills with which our hypothetical island was threatened? That it does not is manifest. We imagined a

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\* It must be remembered that it need not be the protective policy of country B which *directly* and obviously makes it impossible for free trade country A to pay for B's exports. The direct cause might be protection in country C, through which A used to pay its debts to B, but can so pay no longer.

free trade country completely environed by a wall of protection; a wall high enough to make export *first* difficult and *then* impossible. We inferred that it would find imports *first* costly, and *then* unattainable. In actual fact we see Britain hampered indeed by foreign tariffs, yet able, in spite of them, to carry on an export trade which, if it does not increase as we might wish, yet increases rather than diminishes, and an import trade of unexampled magnitude.

25. In what then resides the difference between the two cases? In three separate particulars.

- (a) Foreign countries owe us a great deal of money, which they pay by means of imports into the United Kingdom.\*
- (b) Large areas still remain which are not protected at all.
- (c) Existing protected areas are not completely protected.

It is these three causes, and these alone, which prevent this country undergoing the fate which, in the third example, befell the hypothetical island. Each, therefore, deserves careful consideration.

## VII.

26. As regards the national income from foreign investments, it has to be observed that while it must always be better for the inhabitants of any country to own capital than not to own it, it is better that the capital they own should be earning a profit at home, than that it should be earning the same profit abroad. If, indeed, there is no further room at home for the

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\* Under the first head I do not refer to freights or commissions. These it is more convenient to treat as payment, not for exported capital, but exported services. They should be classed with the payments for ordinary material exports, such as textiles or hardwares. At present we are concerned with the interest on foreign loans, and the profits on commercial undertakings abroad, paid to persons inhabiting this country.

employment of capital, then, no doubt, it will be far better for all concerned that the overflow of wealth should be turned to account elsewhere than that it should run to waste. On the other hand, if capital which goes abroad might have increased the effective demand for British labour, its expatriation is *pro tanto* a loss to the labourer and the nation, if not to the capitalist himself.

27. Now it seems clear that in many cases this expatriation of capital can be, and is, encouraged by foreign protective tariffs. The imposition of a protective duty upon any article of British manufacture has of course the double effect of discouraging its production here, and encouraging its production in the protectionist country—say Belgium. The popular free trade account of what happens in consequence is that, on the one hand, the English manufacturer and artisan are injured by the diversion of industry into some other, and presumably less profitable, branch of British industry; on the other, the Belgian consumer is mulcted in order to find a profit for the Belgian manufacturer. It is the latter, therefore, alone who profits by the transaction. All the rest are losers, though the British loss, so far as this particular industry is concerned, is confined to that part of it which supplied Belgium, and does not affect its success either in the home or in neutral markets.

28. But this is by no means what necessarily happens. It is assumed apparently that the British manufacturer adheres to his country and changes his business. But he may choose the other alternative. He may adhere to his business and (*quâ* manufacturer) change his country. He may transfer, that is to say, all that is transferable of his capital to Belgium; engage there, under the shield of protection, in the very industry from which foreign protection had driven him at home, and possibly compete not only in neutral but in British markets with his unprotected countrymen. It is, I think, manifest that if this should happen the fiscal arrangements of Belgium will have destroyed some invested British capital and some acquired British skill; will have directly injured the

British workman and the Belgian consumer; will have directly benefited the British consumer; will have directly benefited the Belgian workmen and the English capitalist engaged in the Belgian industry; will have (if the capitalist continues to spend his profits at home) indirectly benefited England by increasing her foreign revenue; and will have indirectly injured her industries by giving them a subsidised rival. Without attempting to set out these various losses and gains in a national balance-sheet (which would, of course, show different results for each concrete case), it is, I think, plain that foreign investments of *this* description are by no means the unmixed benefit which some people appear to suppose.

29. We may, however, reasonably hope that the great bulk of our investments abroad are not of this character; but have been on the whole of advantage both to foreigners and to ourselves. It must not, however, be forgotten that the magnitude of these investments is due rather to the fact that we were first in the industrial field, than to the intrinsic merit of our fiscal system. Not every country which adopts free trade is destined to possess a large surplus of available capital, nor even to retain at home all the capital it requires for domestic use.

## VIII.

30. The second advantage which the actual Great Britain possesses over its hypothetical counterpart is to be found in the large portion of the earth's surface where protective tariffs are still, to all intents and purposes, unknown. These free trade areas consist either of countries which are protective in theory but not in practice, where the absence of manufactures makes importation an imperative though unwelcome need (*e.g.*, the States of South America and the small non-manufacturing States of Europe); or of countries whose tariff systems have, through historical circumstances, become more or less subject to international control (*e.g.*, Turkey and China); or of the Dependencies, Crown Colonies, and Protectorates of the British Empire.

31. Of the first it need only be said that so far they add to the neutral markets of the world not because they will, but because they must. They are not converts to the cult of free trade, though under the stress of necessity they obey its precepts. It rests not with us, but with circumstances depending upon the general movement of industry, and the character of their own internal resources, to determine how long they will thus remain fiscally "orthodox" against their wishes.

32. Our position in respect to the second and third class is very different. Here, it is neither the compulsion of economic need, nor the persuasive force of economic argument, which enables us to retain open markets for our manufactures. It is in the last resort on military power that our diplomatic rights in some of these regions, and our territorial rights in others, essentially depend. Without it they would ultimately lapse; and sooner or later these areas would become absorbed by one or other of the great protective powers, and their markets be lost to us for ever. When we reflect how necessary these are to the full success of insular free trade, and remember how in many cases they have been originally won, and how in all cases they are now maintained, I marvel that small armaments, small responsibilities, a small empire, and a large external trade should ever have been considered as harmonious elements in one political ideal.

33. If we look to the future of these various classes of non-protective areas there seems no probability of their increase; while industrial changes, political accidents, and international complications may at any time diminish them. The agricultural states who, if they had any manufactures to protect, would hasten to protect them, may in process of time become "industrialised." The expansion of the Empire has, broadly speaking, reached its limits. The countries whose markets are, by diplomatic arrangement, equally open to all the world, may, in whole or in part, fall under the control of some predominant protectionist Power. In

many directions, therefore, there is a possibility of losing free trade territories. In none does there seem any probability of gaining them ; and it is therefore to the development of their wealth, not the increase of their size, that we must look for any improvement in the opportunities they offer to our enterprise.

## IX.

34. The third reason which prevents Britain from suffering the full penalty which might and would befall a free trade community in a completely protectionist world is that tariffs, even in the most protectionist countries, are not absolutely exclusive. In some of those countries, and for some of our main industries, indeed, no loophole is permitted. The barrier is impregnable. Bradford goods do not go to America, nor does bleach to Russia. Yet on the whole there is a large import into the protected area of the commercial world ; protectionist nations and protectionist colonies are still our most important customers.

35. In order, however, to form an exact estimate of our industrial relation to those communities, we have to consider not merely what is, but what is to be. The tendency of trade, not its momentary position, is what chiefly concerns us. And this gives food for thought.

36. It is, I think, clear that our export trade, which should, other things remaining the same, have grown with our growth and with the yet more rapid growth of some of our customers, has, in fact, done neither one nor the other. Absolutely it may have increased, but its rate of increase has on the whole seriously diminished ; in some important departments no increase is perceptible, in others there are symptoms of decay.

37. The cause of this is commonly set down to the "industrialisation" of the world. How, it is asked, can we expect to provide foreign nations with ever-increasing quantities of our manufactures, since they have learned, at our feet, so amply to

provide for themselves? Britain had formerly an undisputed primacy in the industrial world; she has it no longer; she could not hope to have it. But, after all, the roots of this great change lie deep in the nature of things; why complain of the inevitable?

38. But this argument is wide of the mark. No complaint is made of the relative growth in wealth, population and prosperity of other nations. This ought, on the contrary, to be a matter of rejoicing. We might expect\* on the free trade theory to gain, not to lose by it. It should increase, not diminish, the rate at which we get richer; and the tide of international commerce ought to flow, not merely without slackening, but in a volume proportionate to the growing numbers and wealth of the different populations to which it ministers.

If neither this nor anything like this is happening, it is not simply because "in the nature of things" and by the operation of some inevitable law it is impossible; but because it has been made impossible by the operation of hostile tariffs.† National industries have not been allowed to become mutually supplementary; they have been compelled to become mutually exclusive. Fiscal contrivances have forced them out of co-operative into competitive channels.‡

39. That this is the true theory, on ordinary free trade principles, of what is now taking place, it seems to me im-

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\* Though not with absolute certainty.

† The Board of Trade estimate the *ad valorem* equivalent of the duties levied on our principal exports to be—in the case of Russia, 130 per cent.; of the U.S.A., 72 per cent.; of Austria-Hungary, 32 per cent.; of France, 30 per cent.; of Italy, 27 per cent.; of Germany, 25 per cent.; of Canada, 16 per cent.; of Belgium, 13 per cent.; of New Zealand, 9 per cent.; of Australia, 7 per cent.; of the South African Customs Union, 6 per cent.

‡ I do not, of course, mean that under a system of international free trade there would have been no competition between industrial nations; but only that there would have been much less competition and much more co-operation.

possible to deny. But there are two circumstances accompanying the diminishing rate of increase in our export trade by which some observers are greatly consoled.

They say, in the first place, that if we are losing our predominance in foreign markets, the home market is making corresponding gains. They say, in the second place, that if our staple industries are stationary or retrograde, this is more than made up for by the variety of goods we now manufacture for the foreign consumer. From neither circumstance can I derive much satisfaction. These are precisely the signs which would accompany the struggle of a free trade country so to modify its industries as to pierce the barrier of foreign tariffs. They are presumably, therefore, in part the consequences of protection. If so, the industrial changes in which they consist must surely involve an economic loss. It would be impossible to hold a version of the free trade theory so perverse as one which assumed that while any artificial diversion of industry due to home protection must necessarily be pernicious, the foreign protectionist accidentally confers upon us a benefit which we cannot confer upon ourselves!

## X.

40. A closer examination of the details of our export returns in no way allays the anxiety which theoretical considerations thus suggest. If we exclude coal from the sum of our exports,—still more if we also exclude machinery,—there are signs not only of a diminution relative to population, but of a diminution absolute.

Now what moral, if any, is to be drawn from this result?

I do not press the consideration that by exporting coal we are lessening our national assets—though this is both true and important. Nor yet do I think much illumination is thrown upon the subject by describing coal as “raw material.” This is a phrase which easily lends itself to misconstruction; and if by raw material is meant material whose value is not due in any considerable measure to the expenditure of capital and

labour, then coal is not raw material at all. Much labour and much capital has to be expended before what is stored in the seam becomes fit for the furnace.

41. It is not these considerations which make it desirable, in considering the condition of our export trade, to put coal, machinery, and ships in a class by themselves. The true ground of the distinction is to be found in the fact that these commodities foster in an especial degree the competition of foreign protected manufactures. Though they may swell our exports now, they must therefore tend to diminish them hereafter; and we can hardly regard the very same phenomenon as at once an indication of prosperity and a cause of decline.

42. But why (it may be asked) is the export of coal and machinery more pernicious to the future of free trade than that of other British articles used abroad, either as instruments or materials in the production of tariff-protected goods?

43. In truth it is a matter of degree. And it may readily be admitted that in most cases foreign protection is but little assisted by these contributory exports. If we did not provide them others would, and almost as cheaply. They constitute, therefore, rather a symptom of the disease than an aggravation of it. Indeed, from one point of view the more we export the constituent elements of the protected manufacture, the less its protection injures us. If we imagine an extreme case in which *all* the constituent elements were exported, and nothing was left to the protectionist country but to fit them together, it is manifest that protection would be little more than a name.

When, however, our exports are of articles in the production of which we hold a privileged position, when they are necessary to the foreign protected manufacturer, and when their value is small compared with the total value of the final result to which they contribute, the case is different. Such exports do more than mark the development of protective tariffs; they add to their effect. And, therefore, it is that we may, or rather must, look otherwise upon coal and machinery than we do upon

the manufactured and half-manufactured goods which constitute the rest of our outward-bound trade.

## XI.

44. If, then, an examination of the quantity and character of our exports to tariff-protected countries confirm the unsatisfactory conclusion which theory independently suggests, we have to ask ourselves whether there is reason to anticipate any improvement in the future. Are we to be permitted to take our fair share in the growing industrial labours of the world, and to reap our fair share of their reward ; or is our position going to worsen relatively to that of other nations, or even to worsen absolutely ?

45. I see no satisfactory symptoms. The highly developed industrial countries, like Germany, America, and France, give no sign of any wish to relax their protectionist system. The less developed protectionist communities, like Russia and some of our own self-governing colonies, are busily occupied in building up protected interests within their borders—a process which is doubtless costly to them, but is not on that account the less injurious to us.

46. Nor has it, I think, been sufficiently noted that the injury in these cases is, or tends to become, a double one. The effect of any artificial stimulus to manufacturers in a country like the United States of America, or Russia, or Canada, is to ante-date the period when their food supplies will be required for internal consumption. Protection of manufactures diverts the supply of capital and labour from agriculture to manufactures. It diminishes the relative number of those who grow corn, and increases the relative number of those who eat it without growing it. To us, who not only wish to export manufactures but to import food or (if you prefer it) who have to export manufactures largely because we have to import food, this may become a serious matter ; and in the interests of cheap bread, it is eminently desirable that the produce of the wheat-

growing areas available for exportation should be kept at the highest possible level.

## XII.

47. So far I have only dealt with the injury inflicted on a free trade country by protectionist neighbours through the restriction of markets, the consequent loss of some of the capital and skill by which those markets were formerly supplied, and the diversion of industry into presumably less profitable channels. There is, however, another kind of injury which tariffs, working in alliance with modern methods of trade combination, may inflict upon national enterprise, on which something still requires to be said.

48. In the popular presentation of the free trade case, it is usually argued that howsoever differential tariffs may foster the production of any articles intended for domestic consumption, the country imposing them cripples its power of competing, with that article, in outside markets. Clearly the manufacturer in the protectionist country (so runs the argument) can have no advantages apart from tariffs for the production for the home market of the protected article, otherwise protection would have been superfluous. His position, therefore, in the neutral markets would in any case be worse than that of the rival against whom he is protected. But it is still further worsened by the general operation of protection which raises the cost of living and therefore, it is urged, of production, in the protectionist country. From this it seemingly follows that the free trade manufacturer must always have a double advantage—one natural and one artificial—over his protected rival; so that his predominance is fully secured in neutral markets, and *a fortiori* in his own.

49. The argument is good as far as it goes, but it omits (among many other things) to notice the indirect effort of a contrivance which has only recently been adopted on any considerable scale.

Put shortly, the contrivance is this: In a country where protective duties render outside interference in some industry (say steel) exceedingly difficult, the steel manufacturers combine to fix the home price at a level, which may vary from time to time, but is always well above the cost of production. So far the case does not differ from any other trade combination to raise prices, and protection only facilitates the operation by limiting to a single country the number of persons whose consent is necessary to make the combination effective.

Its further effects, those with which we are here alone concerned, show themselves only when the combination make the export of their protected manufactures play into their general scheme of profit-making.

50. Now there are three things which it is peculiarly difficult for a manufacturer or combination of manufacturers to do, and at the same time peculiarly desirable.

The first is to run their works evenly—that is to say, without undue pressure at one period, without dismissing workmen and leaving plant unused at another.

The second is to design their works on the scale which shall secure the greatest economy of production—which, in the language of political economy, shall take the utmost advantage of the “law of increasing returns.”

The third is to secure a footing in foreign markets which are already occupied.

51. Now, in the attainment of all these objects, any manufacturer or combination of manufacturers who have, with the help of protection, obtained a command of their home market, are at an immense advantage compared with their rivals in a free trade country.

The unprotected manufacturer is compelled either to restrict his plant to a point well within what may sometimes be required of it, or, in ordinary times, to leave it partially idle. Even a small excess of supply may lower the price of his goods out of all proportion; and if it does, he not only loses heavily in respect to this small margin of over-production, but in respect of his whole output.

Now, there is no reason to expect that the plant erected to meet an average demand would reach the exact size most conducive to economy of manufacture. Should it prove to do so it could only be by accident. Neither is it practicable to arrange that the plant shall always be kept working full time. If it is, there must evidently be recurrent periods, during which over-production, with the consequent evils just described, must inevitably take place.

52. Such is the ordinary position of the manufacturer under free trade. Compare with it the position of his protected rival, who controls his home markets. *He* is not haunted by the fear of over-production. If the home demand slackens, compelling him, if he desires to maintain prices, to limit home supply, *he* is not driven, like his less-favoured brother, to attain this result by also limiting output. He is not obliged to close part of his works, or to dismiss some of his hands, or to run his machinery on half time. On the contrary, so long as other countries are good enough to offer him open markets, he can dispose of his surplus abroad, at prices no doubt lower, often very much lower, than the prices which his quasi-monopoly enables him to obtain at home, but at prices which nevertheless make the double transaction, domestic and foreign, remunerative as a whole.

53. Why, it may be asked, is no similar policy open to the manufacturer in a free trade country? Because free trade makes it difficult for him to obtain control of his home markets; and because, unless he has this control, it is difficult for him to fix two prices, a low foreign and a high domestic one. If he attempts it he will be undersold in the home market by his rivals, or even, if the divergence of price exceed the double cost of carriage, by himself! His own goods will be re-imported. He will become his own most dangerous competitor! \*

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\* There are, indeed, exceptional cases, where, even in a free trade country, a monopoly can be established and where no re-importation is possible—certain shipping combinations provide a concrete illustration. Here no distinction can be drawn between free trade and protection.

It is worthy of note that in theory it is not only possible that the foreign prices charged by the quasi-monopolist should be less than the home prices, but even that they should be less than the cost of production. And it has often been so in practice. German steel, for instance, has been sold in this country at a price for which no English manufacturer could produce it—or German manufacturer either, without the double aid of combination and protection.

54. But why (it may be asked) should any free trader object to such a proceeding? After all what it comes to is that the German consumer is amiable enough to make a handsome present to the British consumer and sometimes to the British manufacturer. Why should either the British consumer or the British manufacturer reject it? I was told the other day of a shipbuilder who was able to obtain contracts solely because he had secured a consignment of German steel at a price lower than it could possibly have cost either to a British or a German ironmaster. Why should we refuse to our shipping trade a bounty which the Germans are so generously anxious to confer?

55. The question is a pertinent one; yet I think the answer is conclusive. There is a utilitarian objection, as well as a sentimental one, to a form of competition which most persons would instinctively regard as unfair.

In the first place it disorganises industry. The manufacturing capitalist when investing his money in costly plant, has, in any case, many risks to run—new discoveries, new inventions, new fashions. Add to these his loss, actual or anticipated, through the operation of foreign protection, and his burden becomes insensibly increased. But add yet again the further uncertainty and the further loss due to the system I have just been describing, and he is overweighted indeed. Will the hostile combination keep together long enough to ruin him? Can his credit stand the strain? Is it worth while holding on in the face of certain loss and possible ruin? These are questions which the leaders of the threatened industry cannot but ask. And surely the mere fact that they have to be asked

must shatter that buoyant energy which is the very soul of successful enterprise.

56. This is serious; but this is not all. The "unprotected" manufacturer is not only attacked at home but abroad. He, perhaps, possesses what may be described as the "good will" of some neutral market. He has, in other words, a *clientèle* whom he has served well, and who, under ordinary conditions of trade, would never have deserted him. Suddenly, under the trust system, through no fault of his own, nor through any shortcoming of his staff or plant, he finds himself undersold. It is true that the power of underselling will last no longer than the ring whose monopoly has made it possible. It is also true that in some trades, though only in some, there is nothing so evanescent as these commercial conspiracies. Yet, however short-lived they may be, they have probably lasted long enough to destroy a valuable asset; and if his business survives at all, it will only be by slow and laborious stages that it can reconquer territory reft from it in a day by a tariff-protected combination.

### XIII.

57. I have now said enough to indicate the grounds of my difference with our commercial optimists. At first sight their case seems a good one. Judged by all available tests, both the total wealth and the diffused well-being of the country are greater than they have ever been. We are not only rich and prosperous in appearance, but also, I believe, in reality. I can find no evidence that we are "living on our capital," though in some respects we may be investing it badly. Why then, it is asked, do we trouble ourselves to disturb a system which has been so fruitful in happy results?

58. I will not take up the barren challenge contained in the last phrase, or add to the profitless and inconclusive dispute as to whether the growth in our prosperity is due to a good financial system, and the still greater growth in the recent prosperity of some other nation has been reached

in spite of a bad one. The point to which I desire to direct attention is a different one. I ask the optimists to study tendencies—the dynamics not the statics of trade and manufactures. The ocean we are navigating is smooth enough, but where are we being driven by its tides? Does either theory or experience provide any consolatory answer to this question? Consider some of the points on which I have commented in these notes: the injury which foreign protection is calculated to inflict on a free trade country; its need for open markets: the threatened contraction of existing free trade areas; the increasing severity of tariffs in protectionist areas; the building up of vested protected interests in new countries, which may be discouraged now, but not hereafter; the effect of this protection on our future corn-supply; the uncertainty and loss which tariff-protected trusts are inflicting, and may hereafter inflict, upon British capital invested in Britain.

59. One and all of these evils, actual and prospective, are due to protection. The man who says that their cumulative effect is so small as to be negligible, can hardly describe himself as a “free trader”—at least he can attach but a very small value to free trade. The man who, admitting their reality, does not anticipate their increase has (it seems to me) not learned the lesson which theory and experience agree in teaching. The man who admits their present reality and the probability of their increase, and yet is too contentedly prosperous even to consider whether any mitigation is practicable, appears little short of reckless.

#### XIV.

60. I cannot accept any of these positions. It seems to me clear that we are bound to seek for some mitigation; and that only in one direction can we hope to find it.

The source of all the difficulty being protective tariffs imposed by fiscally independent communities, it is plain that we can secure no concession in the direction of a freer exchange,

except by negotiation, and that our negotiators can but appeal to self-interest or, in the case of our colonies, to self-interest and sentiment combined.

Now, on the free trade theory self-interest should have prevented these tariffs being originally imposed. But it did not; and if argument failed before powerful vested interests were created, it is hardly likely to be effective now.

The only alternative is to do to foreign nations what they always do to each other, and instead of appealing to economic theories in which they wholly disbelieve, to use fiscal inducements which they thoroughly understand. We, and we alone, among the nations are unable to employ this means of persuasion, not because in our hands it need be ineffectual, but because in obedience to "principle" we have deliberately thrown it away.

61. The "principle" to which we pay this strangely incongruous tribute is, of course, the principle of "free trade." But what a curious view of free trade it implies. The object which these fiscal inducements are intended to attain is increased free trade and nothing else; yet simply because the "fiscal inducement" may, *if it fails of its effect but not otherwise*, involve duties not required for revenue purposes, or in certain cases even carry with it some element of protection to home industries, we are to turn away from it as from an accursed thing.

62. This seems to me, and has always seemed to me, extraordinarily foolish. It is certainly quite inconsistent with rational free trade. There is one, and only one, standard by which we can measure the free trade merits of any policy, and that is the degree to which it promotes free trade. This to be sure is as near a tautology as anything well can be, yet seemingly there are free traders to whom it presents itself as heresy, if not as paradox. They regard the maxim "thou shalt not tax except for revenue" not as the concise description of a fiscal ideal, but as a moral imperative of binding force. In their judgment it admits of no qualification or exception. It is, in school jargon, "universal" and "necessary," and could you prove to them that by risking the imposition of the most trifling

protective tariff at home, it was possible to secure the greatest relaxation of protective tariffs abroad, they would only answer that we must not do evil that good may come of it!

63. This attitude of mind seems to me absurd. I hold myself to be in harmony with the true spirit of free trade when I plead for freedom to negotiate that freedom of exchange may be increased. This freedom to negotiate, like all other freedoms, may of course be abused. But are we therefore in a mood of irrational modesty to declare ourselves unfitted to enjoy it? I think myself that it ought not to be difficult to devise a method of turning it to most useful account. But were I proved to be wrong, my opinion on the fundamental question would remain unchanged. Where we fail others may succeed. It cannot be right for a country with free trade ideals to enter into competition with protectionist rivals, self-deprived of the only instrument by which their policy can conceivably be modified. The first and most essential object of our national efforts should be to get rid of the bonds in which we have gratuitously entangled ourselves. The precise manner in which we should use our regained liberty is an important, yet after all only a secondary issue. What is fundamental is that our liberty should be regained.

EXPORTS TO PROTECTED AND UNPROTECTED MARKETS  
OF ALL ARTICLES OF BRITISH PRODUCTION,  
EXCEPT COAL, MACHINERY, AND SHIPS.

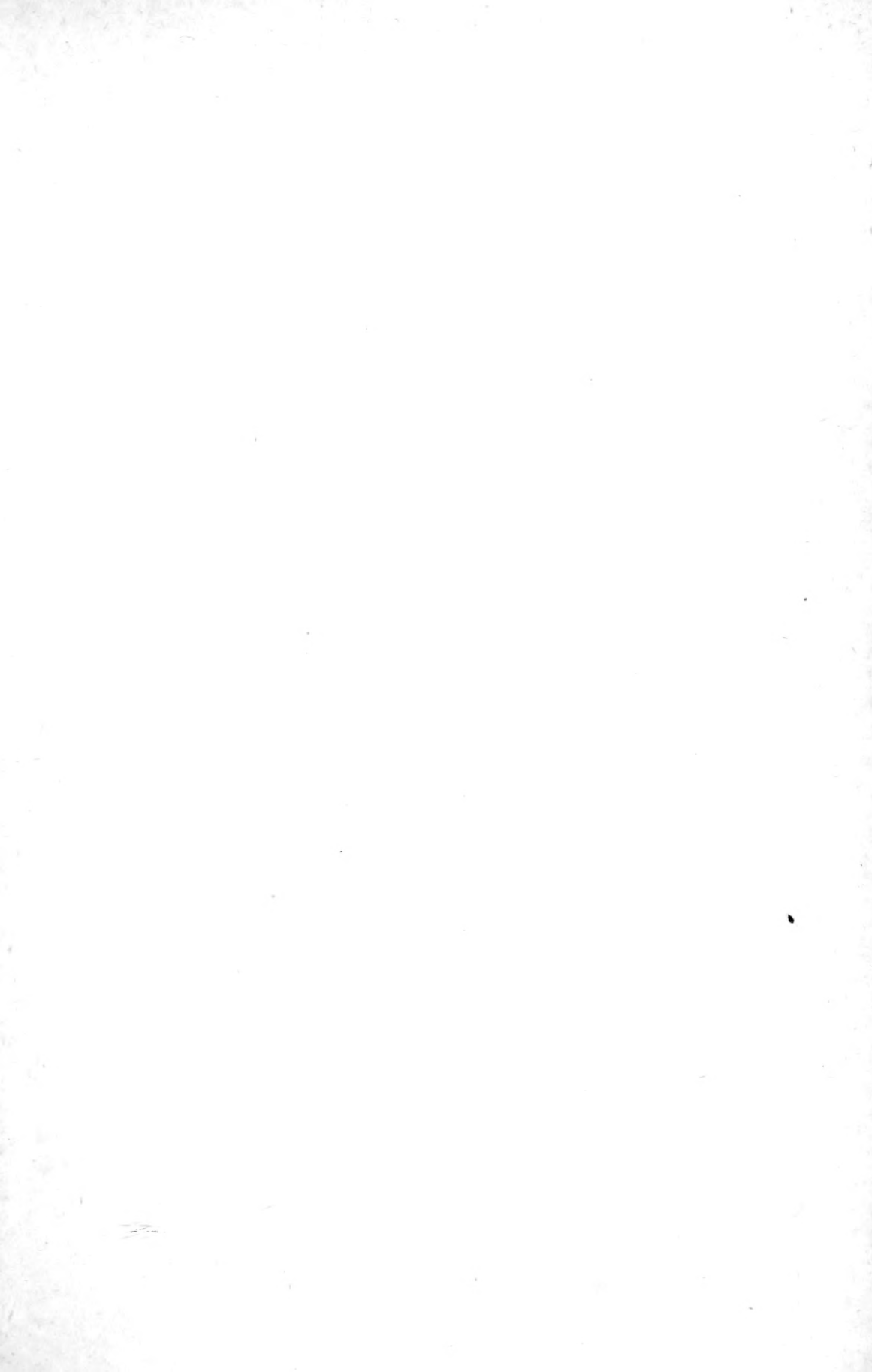
## I

Year.	All Countries.	Principal Protected Foreign Countries.	Principal Protected Colonies (Victoria & Canada).	All other Countries and Colonies.	India.
VALUE.					
	Thousand £.	Thousand £.	Thousand £.	Thousand £.	Thousand £.
1880	205,423	87,124	11,498	106,801	29,278
1890	228,100	89,416	13,497	125,187	31,349
1900	224,364	80,906	12,879	130,579	27,784
1902	231,216	76,667	14,859	139,690	29,742
PERCENTAGE DISTRIBUTION.					
	Per Cent.	Per Cent.	Per Cent.	Per Cent.	Per Cent.
1880	100·0	42·4	5·6	52·0	14·3
1890	100·0	39·2	5·9	54·9	13·7
1900	100·0	36·1	5·7	58·2	12·4
1902	100·0	33·2	6·4	60·4	12·9

## II

Year.	Value of	
	Exports of British Produce except Coal, Machinery, and Ships.	Ditto per head of Population.
	Thousand £.	£.
1881	215,277	6·2
1886	193,186	5·3
1891	213,270	5·6
1896	208,931	5·3
1901	222,726	5·4

NOTE.—The years selected are those for which the decennial census is in each case first available, and the years falling midway between them.

















Balfour

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